

ORIGINAL
OPEN MEETING



MEMORANDUM

2005 SEP 12 P 4: 28

TO: THE COMMISSION

FROM: Utilities Division

AZ CORP COMMISSION
DOCUMENT CONTROL

DATE: September 12, 2005

RE: IN THE MATTER OF THE APPLICATION OF UNS GAS, INC. FOR
APPROVAL OF A PURCHASED GAS ADJUSTOR SURCHARGE (DOCKET
NO. G-04204A-05-0596)

On August 17, 2005, UNS Gas, Inc. ("UNS") filed for Commission approval of a \$0.27 per therm purchased gas adjustor ("PGA") surcharge, effective October 1, 2005.

Previously, in Decision NO. 67730 (March 31, 2005), the Commission approved a \$0.03 per therm PGA surcharge, effective until the PGA bank balance reaches zero or the Commission orders otherwise. This PGA surcharge is still in effect at this time, so therefore UNS' requested \$0.27 per therm PGA surcharge represents a \$0.24 per therm increase in the PGA surcharge that customers would see if UNS' request is approved. UNS' application cites the on-going high cost of natural gas as well as the upcoming increased cost for service on El Paso Natural Gas Company's interstate pipeline system as factors leading to UNS' filing for the \$0.27 per therm PGA surcharge. UNS has indicated that, absent its requested PGA surcharge, the PGA bank balance will reach \$25 million in January 2006 and \$45 million in January 2007. The most recent monthly PGA report filed by UNS shows an undercollected PGA bank balance of \$3,805,459 as of the end of June 2005. UNS has indicated to Staff that the \$0.27 per therm surcharge request comprises approximately \$0.19 per therm in the cost of the natural gas commodity, and approximately \$0.08 per therm for the projected increased cost of service on the El Paso Natural Gas Company ("El Paso") pipeline.

Regarding the El Paso portion of the projected cost increase, this refers to the rate case El Paso filed at the Federal Energy Regulatory Commission ("FERC") on June 30, 2005. Under FERC rules, El Paso is allowed to implement its proposed rates beginning in January 2006, subject to refund if the final result of the rate proceeding differs. UNS' projections are based upon its contracted volume on El Paso and El Paso's new proposed rates. The increased costs for El Paso service result from two primary factors, an increase in UNS' billing determinants from the level set in the 1996 settlement agreement to the current contract volume level, and an increase in the rates paid per unit of contract volume. The first factor, the billing determinant increase, is a certain increase, as resetting the billing determinants is just part and parcel of a new rate proceeding. The second part, the rate increase per unit of volume, has some level of uncertainty. Under El Paso's current Firm Transportation ("FT-1") service, El Paso's monthly reservation rate for Arizona is \$7.99156 per decatherm ("dth"). Under El Paso's proposed tariffs, an FT-1 shipper, such as UNS, would pay a monthly reservation rate of \$10.0496 per dth

for basic FT-1 service. However, part of El Paso's rate design proposal is that basic FT-1 service will be much more restricted regarding the operational flexibility a shipper may utilize. Therefore, UNS projects that it will have to take service under a new, more expensive rate schedule entitled Hourly No-Notice Transportation Service Three Hour Enhanced Service Option, carrying a monthly reservation rate of \$11.9715 per dth. It is possible that as the El Paso rate proceeding moves forward, that the rates for this new service and other factors could change the amount UNS will eventually pay per unit of volume, though some level of increase appears inevitable.

Regarding the \$0.19 per therm portion of the proposed PGA surcharge relating to higher commodity costs, it is challenging to assess how large a commodity cost increase UNS will be facing through the 2005-2006 winter heating season and beyond. UNS' price estimates reflect natural gas which the Company has hedged going forward. For the portion of UNS' gas supply portfolio which is not hedged, UNS projected its gas costs by taking the New York Mercantile Exchange ("NYMEX") natural gas futures contract prices at the time of the filing and making a downward adjustment to reflect the differential UNS usually sees between contracting for NYMEX priced supplies and supplies from the San Juan and Permian basins, where UNS' gas typically comes from. This results in price projections of between \$8.00 and \$10.00 per decatherm from September 2005 to March 2006, topping out at nearly \$10.00 in January 2006. From April 2006 through October 2006, UNS projects spot purchases between \$7.50 and \$8.00 per decatherm, with prices then rising again going into the 2006-2007 winter heating season.

It is important to note that natural gas market conditions have shown significant volatility since UNS' filing on August 17, 2005. Natural gas prices have been at record highs for much of the past summer, and prices jumped significantly in response to Hurricane Katrina. Comparing San Juan and Permian spot market prices on August 17th to the most recent data available for transactions September 9, 2005, both basin spot market prices are higher, with the San Juan spot price increasing from \$7.82 to \$8.365 per dth and the Permian spot price increasing from \$8.775 to \$8.94 per dth. Natural gas futures prices have been more volatile than the spot market prices seen in the San Juan and Permian basins in recent weeks, though some eastern spot market prices have shown significantly more volatility. As the Commission discussed at its September 8, 2005 Natural Gas Forum, the upcoming winter could see some of the highest sustained natural gas prices since wellhead prices were deregulated in the 1980s. In such a circumstance, any price projection involving significant spot market volumes is highly speculative, as unfavorable conditions could push natural gas prices significantly higher than UNS projections or more favorable conditions could move natural gas prices moderately lower. Staff believes that given the information available at this time, UNS' projections of its cost of natural gas in upcoming months appear reasonable for the purpose of considering UNS' application for a PGA surcharge.

Staff recommends implementation of the \$0.19 per therm portion of UNS' PGA surcharge request related to higher commodity costs, for a 12-month period beginning November 1, 2005. Regarding the El Paso rate increase costs, Staff believes that any PGA surcharge related to those costs should be implemented beginning in January 2006, consistent with the time UNS will actually begin incurring those costs. Further, given that there is some possibility that the

final rates El Paso implements could be some amount lower than the proposed El Paso rates which go into effect January 1, 2006, Staff believes that implementation of a \$0.06 per therm portion of the PGA surcharge to reflect higher El Paso costs is reasonable. This represents over three quarters of the \$0.08 per therm El Paso-related portion of the proposed \$0.27 per therm PGA surcharge.

In summary, the combination of the commodity and El Paso portions of the PGA surcharge as contemplated by Staff would result in the implementation of a \$0.19 per therm PGA surcharge in November 2005, with the PGA surcharge increasing to \$0.25 per therm in January 2006 and continuing through October 2006. After this PGA surcharge expires at the end of October 2006, Staff believes there is some benefit in then implementing a \$0.05 per therm PGA surcharge which would be in effect until the PGA bank balance reaches zero or the Commission orders otherwise. This would provide an additional relatively small increment of on-going relief to UNS after the larger PGA surcharge expires at the end of October 2006, possibly obviating the need for another PGA surcharge filing in the fall of 2006. Staff's proposal would also result in having in effect a short phase-in period for the PGA surcharge, with the November and December 2005 PGA surcharges of \$0.19 per therm ramping up to the \$0.25 per therm. Such a result is logical in this case given the timing of the El Paso rate case schedule.

It should be noted that, apart from the level of the PGA surcharge being approved in this proceeding, the monthly PGA rate is projected to continue to rise through 2005 and 2006, subject to the \$0.10 per therm band. Thus the increased cost of gas UNS customers will be seeing on their bills will be the sum of the higher PGA surcharge and the year-over-year increase in the monthly PGA rate.

UNS' requested implementation date of October 1, 2006, does not provide time for the Commission to fully consider and act on the filing, so an implementation date of November 1, 2006 (the beginning of the November billing cycle) is more appropriate.

While Staff is recommending the PGA surcharge design described above, there are a variety of other possible scenarios that the Commission may wish to consider in addressing UNS' application. Attached to this memo are pages listing 12 possible scenarios, including UNS' proposal (Scenario One) and Staff's proposal (Scenario Four). All scenarios assume any PGA surcharge is implemented starting in November 2005. Also attached are sheets showing the PGA bank balance levels under each scenario for each month, the monthly impact of the PGA surcharge in each month, and the projected average residential monthly bill each month under each scenario. Staff would note that certain of these scenarios, such as the "Do Nothing" scenario are provided to illustrate a range of possible PGA surcharge levels, but in some cases do not appear to address the projected undercollected PGA bank balance on an on-going basis to the extent which seems to be necessary.

Under UNS' proposed PGA surcharge, the monthly PGA bank balance is projected to increase through the winter of 2005-2006, then decline to near zero in the summer of 2006, before increasing again to approximately \$14.6 million in January 2007. By comparison, Staff's

proposed PGA surcharge follows a roughly similar pattern, though recoveries are shifted a small amount into the future. However, by January 2007, the projected PGA bank balance under Staff's proposal is \$16.2 million, within \$1.6 million of where the bank balance would be under UNS' proposal, and under Staff's proposal there would still be a \$0.05 per therm surcharge in place to further address any undercollection. The inclusion of a CARES program exemption, as discussed below, would increase the projected bank balances under any of the possible scenarios, as discussed below for the UNS and Staff proposals.

One concern the Commission has expressed in regard to natural gas prices is the impact of a sizable PGA surcharge on low income customers. Previously, in Decision Number 66861 (March 23, 2004), the Commission exempted UNS customers taking service under the Customer Assistance Residential Energy Support ("CARES") tariff, which provides a rate discount to low income customers, from paying the PGA surcharge approved in that decision. Staff believes that a similar provision is warranted in this case and recommends that CARES customers be exempted from paying the PGA surcharge levels approved in this proceeding. UNS estimates that under its proposed PGA surcharge level, exempting CARES customers will result in a reduced PGA bank balance collection of \$762,335 over the proposed 12-month period. Under Staff's proposal, the CARES exemption would reduce the PGA bank balance collection by approximately \$651,000 over the proposed 12 month period.

The table below shows what an average residential customer in January, using 105 therms, paid in January 2005 and is projected to pay in January 2006 under the UNS proposal, Staff proposal, and Do Nothing scenario.

Bill Component	January 2005 – Actual Bill	January 2006 – UNS Proposal	January 2006 – Staff Proposal	January 2006 – Do Nothing Scenario
Customer Charge	\$7.00	\$7.00	\$7.00	\$7.00
Tariffed Rate - \$0.7004 per therm)	\$73.54	\$73.54	\$73.54	\$73.54
Monthly PGA Rate	\$18.15 (\$0.1729 per therm)	\$28.27 (\$0.2692 per therm)	\$28.27 (\$0.2692 per therm)	\$28.27 (\$0.2692 per therm)
PGA Surcharge	\$0.00	\$28.35 (\$0.27 per therm)	\$26.25 (\$0.25 per therm)	\$3.15 (\$0.03 per therm)
Total Bill	\$98.44	\$136.79	\$134.70	\$111.66
Percent Increase Over Jan. 2005	NA	39.0%	36.8%	13.4%

Note: Bill estimates shown in this memo and attachments do not include taxes and regulatory assessments.

It is worth noting that of the total increase shown under the UNS and Staff proposals, roughly one third of that increase is projected to result from the automatic movement of the

monthly PGA rate and the current \$0.03 per therm PGA surcharge as shown under the Do Nothing scenario, with approximately two thirds being attributable to the increased PGA surcharge.

The Commission has placed a strong emphasis on Arizona local distribution companies, including UNS, conducting strong outreach efforts to try to make customers aware of what is happening regarding natural gas prices and the rates they pay as well as possible methods for customers to address the rising cost of natural gas service in Arizona. At the Commission's September 8, 2005 Natural Gas Forum, there was a significant amount of discussion regarding such outreach efforts in light of the impending winter heating season.

Staff recommends approval of a PGA surcharge of \$0.19 per therm effective in November and December 2005, a PGA surcharge of \$0.25 per therm effective January 2006 through October 2006, and a PGA surcharge of \$0.05 per therm effective from November 2006 until UNS' PGA bank balance reaches zero or the Commission orders otherwise. Staff further recommends that customers enrolled in the CARES program be exempted from paying the PGA surcharge approved in this proceeding. Staff further recommends that UNS engage in an immediate, highly visible and meaningful public relations campaign, in consultation with Staff, to inform its customers of (1) the specific details of the PGA surcharge level(s) approved in this proceeding and how it benefits customers now rather than later to recover natural gas costs; (2) the impact of the PGA surcharge level(s) on customer bills; (3) general natural gas price circumstances leading to the PGA surcharge; and (4) ways in which UNS' customers can try to manage the higher rates they are facing. Heavy emphasis should be placed on promoting programs such as budget billing (especially during the time of year that it would be most beneficial to customers to apply), the CARES program, and ways to reduce consumption.



Ernest G. Johnson
Director
Utilities Division

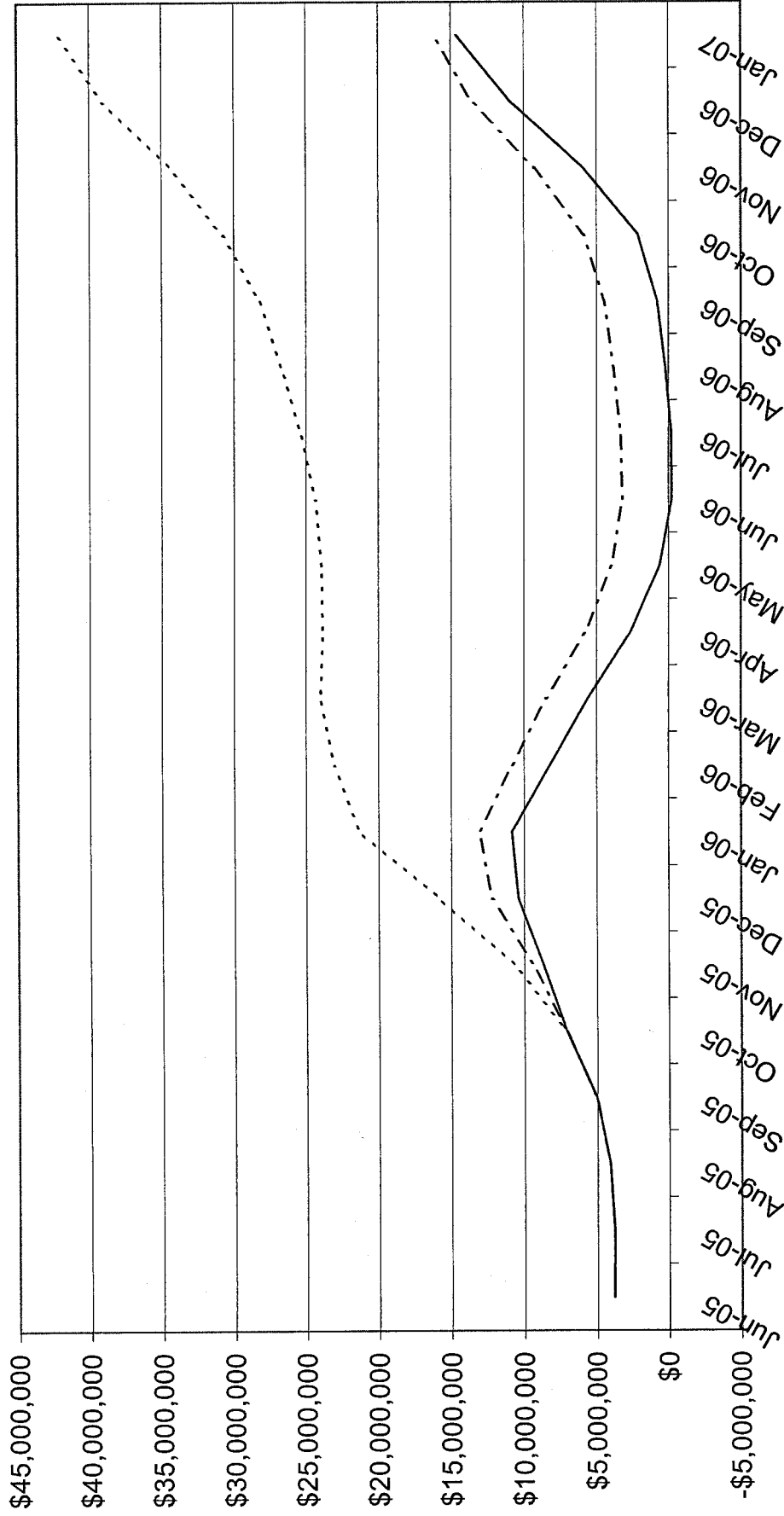
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ORIGINATOR: Robert Gray

Summary of Scenarios for UNS Gas PGA Surcharge Analysis

1. UNS Proposal - \$0.27 per therm for one year, from November 2005 through October 2006. UNS' filed proposal began the PGA surcharge in October 2005, but that has been adjusted to reflect the more likely implementation date of November 2005.
2. UNS Proposal Without El Paso - \$0.19 per therm for one year, from November 2005 through October 2006
3. UNS Proposal With El Paso Beginning in January 2006 - \$0.19 per therm in November and December 2005 and \$0.27 per therm from January 2006 through October 2006
4. Staff Proposal – Commodity Portion With Partial El Paso Inclusion - \$0.19 per therm in November and December 2005, \$0.25 per therm in January 2006 through October 2006, and \$0.05 per therm from November 2006 until such time as the PGA bank balance reaches zero or the Commission orders otherwise, whichever comes first.
5. Two Year Amortization - \$0.13 per therm from November 2005 through October 2007
6. Reduced Amortization of \$0.15 per therm - \$0.15 per therm from November 2005 through October 2006
7. Reduced Amortization of \$0.10 per therm - \$0.10 per therm from November 2005 through October 2006
8. Add \$0.05 to UNS Request Due to Hurricane, increase Commodity Prices 10 percent for non-hedged gas supplies - \$0.32 per therm from November 2005 through October 2006
9. \$0.15 in winter, \$0.30 in summer (Oct, May-Sept.) - \$0.15 per therm from November 2005 through April 2006 and \$0.30 per therm May 2006 through October 2006
10. Do Nothing – The \$0.03 per therm PGA surcharge currently approved remains in place with no further action
11. UNS Proposal with 20 percent higher natural gas costs - \$0.27 per therm from November 2005 through October 2006. Tests the impact of higher than projected natural gas prices.
12. Commodity Portion With Partial El Paso Inclusion Extended Until Bank Balance Reaches Zero – This is equivalent to the Staff proposal in Scenario number four except that after the initial 12 month period, the \$0.25 per therm PGA surcharge is retained instead of being reduced to a \$0.05 per therm PGA surcharge as in Scenario number four. The \$0.25 per therm PGA surcharge would be retained until the bank balances reaches zero or the Commission orders otherwise, whichever comes first.

Monthly PGA Bank Balances Under UNS, Staff, and Do Nothing Scenarios



— Scenario 1 - UNS Proposal - - - Scenario 4 - Staff Proposal Scenario 10 - Do Nothing

End of Month PGA Bank Balance Under Each Scenario

Scenario	Jun-05	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05	Jan-06	Feb-06	Mar-06
1	\$3,805,459	\$3,794,935	\$4,090,525	\$5,035,919	\$7,096,043	\$8,685,890	\$10,402,816	\$10,835,893	\$8,218,535	\$5,599,102
2	\$3,805,459	\$3,794,935	\$4,090,525	\$5,035,919	\$7,096,043	\$9,360,455	\$12,205,758	\$14,312,512	\$13,156,277	\$11,731,858
3	\$3,805,459	\$3,794,935	\$4,090,525	\$5,035,919	\$7,096,043	\$9,360,455	\$12,205,758	\$12,643,477	\$10,030,774	\$7,416,007
4	\$3,805,459	\$3,794,935	\$4,090,525	\$5,035,919	\$7,096,043	\$9,360,455	\$12,205,758	\$13,060,736	\$10,812,149	\$8,494,970
5	\$3,805,459	\$3,794,935	\$4,090,525	\$5,035,919	\$7,096,043	\$9,866,379	\$13,557,964	\$16,919,976	\$16,859,584	\$16,331,426
6	\$3,805,459	\$3,794,935	\$4,090,525	\$5,035,919	\$7,096,043	\$9,697,738	\$13,107,228	\$16,050,821	\$15,625,148	\$14,798,237
7	\$3,805,459	\$3,794,935	\$4,090,525	\$5,035,919	\$7,096,043	\$10,119,341	\$14,234,067	\$18,223,708	\$18,711,237	\$18,631,209
8	\$3,805,459	\$3,916,040	\$4,334,116	\$5,467,042	\$7,829,132	\$9,578,570	\$11,537,662	\$12,084,583	\$9,382,663	\$6,794,571
9	\$3,805,459	\$3,794,935	\$4,090,525	\$5,035,919	\$7,096,043	\$9,697,738	\$13,107,228	\$16,050,821	\$15,625,148	\$14,798,237
10	\$3,805,459	\$3,794,935	\$4,090,525	\$5,035,919	\$7,096,043	\$10,709,586	\$15,811,841	\$21,265,749	\$23,029,947	\$23,995,552
11	\$3,805,459	\$4,037,145	\$4,577,708	\$5,897,802	\$7,431,708	\$11,323,740	\$14,955,208	\$17,785,335	\$16,985,273	\$15,922,974
12	\$3,805,459	\$3,794,935	\$4,090,525	\$5,035,919	\$7,096,043	\$9,360,455	\$12,205,758	\$13,060,736	\$10,812,149	\$8,494,970

Scenario	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06	Jan-07
1	\$2,629,349	\$632,976	-\$230,905	-\$198,402	\$229,624	\$788,714	\$2,116,666	\$5,956,148	\$10,930,322	\$14,628,575
2	\$9,696,193	\$8,393,380	\$7,949,824	\$8,306,418	\$9,036,498	\$9,918,424	\$11,658,556	\$15,522,608	\$20,521,416	\$24,244,366
3	\$4,450,933	\$2,459,250	\$1,600,072	\$1,637,290	\$2,070,042	\$2,633,872	\$3,966,575	\$7,810,821	\$12,789,771	\$16,492,811
4	\$5,762,248	\$3,942,783	\$3,187,510	\$3,304,572	\$3,811,656	\$4,455,010	\$5,889,570	\$9,302,922	\$13,557,423	\$16,183,338
5	\$14,996,326	\$14,213,683	\$14,085,370	\$14,685,034	\$15,641,653	\$16,765,706	\$18,814,973	\$21,564,254	\$24,685,064	\$25,613,068
6	\$13,229,615	\$12,273,582	\$12,040,188	\$12,558,829	\$13,439,935	\$14,483,278	\$16,429,501	\$20,305,838	\$25,316,963	\$29,052,261
7	\$17,646,392	\$17,123,835	\$17,153,143	\$17,874,341	\$18,944,231	\$20,189,347	\$22,393,182	\$26,284,876	\$31,311,397	\$35,062,131
8	\$3,783,068	\$1,752,752	\$859,101	\$899,668	\$1,367,440	\$1,975,772	\$3,436,676	\$7,973,109	\$14,049,102	\$19,127,101
9	\$13,229,615	\$11,007,276	\$10,019,981	\$9,965,245	\$10,314,385	\$10,786,884	\$11,994,830	\$15,859,748	\$20,859,424	\$24,583,244
10	\$23,828,056	\$23,912,359	\$24,309,446	\$25,314,220	\$26,648,402	\$28,175,994	\$30,740,483	\$34,392,163	\$39,002,586	\$42,125,663
11	\$14,038,018	\$12,841,398	\$12,444,073	\$12,898,508	\$13,784,289	\$14,845,728	\$16,955,019	\$22,230,275	\$29,484,759	\$36,054,073
12	\$5,762,248	\$3,942,783	\$3,187,510	\$3,304,572	\$3,811,656	\$4,455,010	\$5,889,570	\$7,559,538	\$8,896,389	\$7,193,890

Note: The projected monthly PGA bank balances shown on this page do not include an adjustment for a CARES exemption. The estimated adjustment for the CARES exemption is approximately \$760,000 under the UNS proposal and approximately \$651,000 under the Staff proposal for the initial 12 month period.

Scenario	Scenario A												Scenario B												Scenario C											
	Jan-05	Jun-05	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05	Jan-06	Feb-06	Mar-06	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07				
Scenario A	1	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$13.05	\$23.63	\$28.27	\$23.73	\$17.18	\$9.95	\$5.42	\$4.00	\$2.82	\$3.76	\$4.05	\$5.50	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00			
	2	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$9.18	\$16.63	\$19.89	\$16.70	\$12.09	\$7.00	\$3.81	\$2.85	\$2.85	\$3.76	\$2.85	\$3.87	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00			
	3	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$9.18	\$16.63	\$19.89	\$23.73	\$23.73	\$17.18	\$9.95	\$5.42	\$4.00	\$3.76	\$4.05	\$5.50	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00			
	4	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$9.18	\$16.63	\$19.89	\$23.73	\$23.73	\$17.18	\$9.95	\$5.42	\$4.00	\$3.76	\$4.05	\$5.50	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00			
	5	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$9.18	\$16.63	\$19.89	\$23.73	\$23.73	\$17.18	\$9.95	\$5.42	\$4.00	\$3.76	\$4.05	\$5.50	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00			
	6	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$9.18	\$16.63	\$19.89	\$23.73	\$23.73	\$17.18	\$9.95	\$5.42	\$4.00	\$3.76	\$4.05	\$5.50	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00			
	7	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$9.18	\$16.63	\$19.89	\$23.73	\$23.73	\$17.18	\$9.95	\$5.42	\$4.00	\$3.76	\$4.05	\$5.50	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00			
	8	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$9.18	\$16.63	\$19.89	\$23.73	\$23.73	\$17.18	\$9.95	\$5.42	\$4.00	\$3.76	\$4.05	\$5.50	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00			
	9	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$9.18	\$16.63	\$19.89	\$23.73	\$23.73	\$17.18	\$9.95	\$5.42	\$4.00	\$3.76	\$4.05	\$5.50	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00			
	10	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$9.18	\$16.63	\$19.89	\$23.73	\$23.73	\$17.18	\$9.95	\$5.42	\$4.00	\$3.76	\$4.05	\$5.50	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00		
	11	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$9.18	\$16.63	\$19.89	\$23.73	\$23.73	\$17.18	\$9.95	\$5.42	\$4.00	\$3.76	\$4.05	\$5.50	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00		
	12	\$0.00	\$0.60	\$0.44	\$0.42	\$0.45	\$0.61	\$9.18	\$16.63	\$19.89	\$23.73	\$23.73	\$17.18	\$9.95	\$5.42	\$4.00	\$3.76	\$4.05	\$5.50	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00		
Scenario B	1	\$20.47	\$17.18	\$9.95	\$5.42	\$4.00	\$2.82	\$3.7																												

Total Residential Customer Bill Under Each Scenario

Scenario	Jan-05	Jun-05	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05	Jan-06	Feb-06
1	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$66.64	\$115.62	\$136.79	\$119.38
2	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$62.78	\$108.62	\$128.41	\$112.35
3	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$62.78	\$108.62	\$136.79	\$119.38
4	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$62.78	\$108.62	\$134.70	\$117.62
5	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$59.88	\$103.37	\$122.13	\$107.07
6	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$60.85	\$105.12	\$124.23	\$108.83
7	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$58.43	\$100.75	\$118.99	\$104.44
8	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$59.06	\$120.00	\$142.03	\$123.77
9	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$60.85	\$105.12	\$124.23	\$108.83
10	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$55.05	\$94.62	\$111.66	\$98.28
11	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$66.64	\$115.62	\$136.79	\$119.38
12	\$98.44	\$26.76	\$21.59	\$20.71	\$21.78	\$27.08	\$62.78	\$108.62	\$134.70	\$117.62

Scenario	Mar-06	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06	Jan-07
1	\$105.08	\$89.74	\$55.40	\$33.58	\$26.62	\$25.44	\$26.89	\$34.00	\$58.43	\$100.60	\$118.99
2	\$99.02	\$84.65	\$52.45	\$31.98	\$25.43	\$24.33	\$25.68	\$32.37	\$58.43	\$100.60	\$118.99
3	\$105.08	\$89.74	\$55.40	\$33.58	\$26.62	\$25.44	\$26.89	\$34.00	\$58.43	\$100.60	\$118.99
4	\$103.57	\$88.47	\$54.66	\$33.18	\$26.32	\$25.16	\$26.59	\$33.59	\$60.85	\$104.97	\$124.23
5	\$94.47	\$80.83	\$50.24	\$30.77	\$24.54	\$23.49	\$24.78	\$31.15	\$64.71	\$111.97	\$132.60
6	\$95.99	\$82.11	\$50.98	\$31.17	\$24.84	\$23.77	\$25.08	\$31.55	\$58.43	\$100.60	\$118.99
7	\$92.20	\$78.93	\$49.13	\$30.17	\$24.10	\$23.07	\$24.33	\$30.54	\$58.43	\$100.60	\$118.99
8	\$108.87	\$92.92	\$57.24	\$34.59	\$27.36	\$26.14	\$27.64	\$35.01	\$58.43	\$100.60	\$118.99
9	\$95.99	\$82.11	\$56.50	\$34.18	\$27.06	\$25.86	\$27.34	\$34.61	\$58.43	\$100.60	\$118.99
10	\$86.89	\$74.47	\$46.55	\$28.76	\$23.06	\$22.10	\$23.28	\$29.11	\$59.88	\$103.22	\$122.13
11	\$105.08	\$89.74	\$55.40	\$33.58	\$26.62	\$25.44	\$26.89	\$34.00	\$58.43	\$100.60	\$118.99
12	\$103.57	\$88.47	\$54.66	\$33.18	\$26.32	\$25.16	\$26.59	\$33.59	\$70.51	\$122.47	\$145.17

Note: Customer bills are based upon average residential customer usage in each month and do not reflect taxes and regulatory assessments.

per therm

Scenario

Average Residential Customer Bill Absent any PGA Surcharge

Avg. Res. Cons. Therms Customer Charge Tariffed Rate Monthly PGA rate Estimated Monthly Bill Absent PGA Surcharge	Jan-05	Jun-05	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05	Jan-06	Feb-06	
	105	20	15	14	15	20	48	88	105	88	
	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	
	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	
	\$0.1729	\$0.2537	\$0.2546	\$0.2535	\$0.2541	\$0.2560	\$0.2639	\$0.2709	\$0.2692	\$0.3081	
	\$98.44	\$26.16	\$21.15	\$20.29	\$21.33	\$26.46	\$53.60	\$92.00	\$108.52	\$95.65	
Avg. Res. Cons. Therms Customer Charge Tariffed Rate Monthly PGA rate Estimated Monthly Bill Absent PGA Surcharge	Mar-06	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06	Jan-07
	76	64	37	20	15	14	15	20	48	88	105
	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00	\$7.00
	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004	\$0.7004
	\$0.3233	\$0.3301	\$0.3427	\$0.3535	\$0.3535	\$0.3535	\$0.3541	\$0.3560	\$0.3639	\$0.3692	\$0.3692
	\$84.61	\$72.56	\$45.45	\$28.16	\$22.62	\$21.68	\$22.83	\$28.50	\$58.43	\$100.60	\$118.99

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BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION)
OF UNS GAS, INC. FOR APPROVAL OF A)
PURCHASED GAS ADJUSTOR)
SURCHARGE)
_____)

DOCKET NO. G-04204A-05-0596
DECISION NO. _____
ORDER

Open Meeting
September 27 and 28, 2005
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. UNS Gas, Inc. ("UNS") is engaged in providing natural gas service within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission.
 2. On August 17, 2005, UNS filed for Commission approval of a \$0.27 per therm purchased gas adjustor ("PGA") surcharge, effective October 1, 2005.
 3. Previously, in Decision No. 67730 (March 31, 2005), the Commission approved a \$0.03 per therm PGA surcharge, effective until the PGA bank balance reaches zero or the Commission orders otherwise. This PGA surcharge is still in effect at this time, so therefore UNS' requested \$0.27 per therm PGA surcharge represents a \$0.24 per therm increase in the PGA surcharge that customers would see if UNS' request is approved.
 4. UNS' application cites the on-going high cost of natural gas as well as the upcoming increased cost for service on El Paso Natural Gas Company's interstate pipeline system as factors leading to UNS' filing for the \$0.27 per therm PGA surcharge.
- ...

1 5. UNS has indicated that, absent its requested PGA surcharge, the PGA bank balance
2 will reach \$25 million in January 2006 and \$45 million in January 2007. The most recent monthly
3 PGA report filed by UNS shows an undercollected PGA bank balance of \$3,805,459 as of the end
4 of June 2005.

5 6. UNS has indicated to Staff that the \$0.27 per therm surcharge request comprises
6 approximately \$0.19 per therm in the cost of the natural gas commodity, and approximately \$0.08
7 per therm for the projected increased cost of service on the El Paso Natural Gas Company ("El
8 Paso") pipeline.

9 7. Regarding the El Paso portion of the projected cost increase, this refers to the rate
10 case El Paso filed at the Federal Energy Regulatory Commission ("FERC") on June 30, 2005.
11 Under FERC rules, El Paso is allowed to implement its proposed rates beginning in January 2006,
12 subject to refund if the final result of the rate proceeding differs. UNS' projections are based upon
13 its contracted volume on El Paso and El Paso's new proposed rates.

14 8. The increased costs for El Paso service result from two primary factors, an increase
15 in UNS' billing determinants from the level set in the 1996 settlement agreement to the current
16 contract volume level, and an increase in the rates paid per unit of contract volume. The first
17 factor, the billing determinant increase, is a certain increase, as resetting the billing determinants is
18 just part and parcel of a new rate proceeding. The second part, the rate increase per unit of
19 volume, has some level of uncertainty. Under El Paso's current Firm Transportation ("FT-1")
20 service, El Paso's monthly reservation rate for Arizona is \$7.99156 per decatherm ("dth"). Under
21 El Paso's proposed tariffs, an FT-1 shipper, such as UNS, would pay a monthly reservation rate of
22 \$10.0496 per dth for basic FT-1 service.

23 9. However, part of El Paso's rate design proposal is that basic FT-1 service will be
24 much more restricted regarding the operational flexibility a shipper may utilize. Therefore, UNS
25 projects that it will have to take service under a new, more expensive rate schedule entitled Hourly
26 No-Notice Transportation Service Three Hour Enhanced Service Option, carrying a monthly
27 reservation rate of \$11.9715 per dth. It is possible that as the El Paso rate proceeding moves
28

1 forward, that the rates for this new service and other factors could change the amount UNS will
2 eventually pay per unit of volume, though some level of increase appears inevitable.

3 10. Regarding the \$0.19 per therm portion of the proposed PGA surcharge relating to
4 higher commodity costs, it is challenging to assess how large a commodity cost increase UNS will
5 be facing through the 2005-2006 winter heating season and beyond. UNS' price estimates reflect
6 natural gas which the Company has hedged going forward.

7 11. For the portion of UNS' gas supply portfolio which is not hedged, UNS projected
8 its gas costs by taking the New York Mercantile Exchange ("NYMEX") natural gas futures
9 contract prices at the time of the filing and making a downward adjustment to reflect the
10 differential UNS usually sees between contracting for NYMEX priced supplies and supplies from
11 the San Juan and Permian basins, where UNS' gas typically comes from. This results in price
12 projections of between \$8.00 and \$10.00 per decatherm from September 2005 to March 2006,
13 topping out at nearly \$10.00 in January 2006. From April 2006 through October 2006, UNS
14 projects spot purchases between \$7.50 and \$8.00 per decatherm, with prices then rising again
15 going into the 2006-2007 winter heating season.

16 12. It is important to note that natural gas market conditions have shown significant
17 volatility since UNS' filing on August 17, 2005. Natural gas prices have been at record highs for
18 much of the past summer and prices jumped significantly in response to Hurricane Katrina.

19 13. Comparing San Juan and Permian spot market prices on August 17th to the most
20 recent data available for transactions September 9, 2005, both basin spot market prices are higher,
21 with the San Juan spot price increasing from \$7.82 to \$8.365 per dth and the Permian spot price
22 increasing from \$8.775 to \$8.94 per dth. Natural gas futures prices have been more volatile than
23 the spot market prices seen in the San Juan and Permian basins in recent weeks, though some
24 eastern spot market prices have shown significantly more volatility.

25 14. As the Commission discussed at its September 8, 2005 Natural Gas Forum, the
26 upcoming winter could see some of the highest sustained natural gas prices since wellhead prices
27 were deregulated in the 1980s. In such a circumstance, any price projection involving significant
28 spot market volumes is highly speculative, as unfavorable conditions could push natural gas prices

1 significantly higher than UNS projections or more favorable conditions could move natural gas
2 prices moderately lower.

3 15. Staff believes that given the information available at this time, UNS' projections of
4 its cost of natural gas in upcoming months appear reasonable for the purpose of considering UNS'
5 application for a PGA surcharge.

6 16. Staff recommends implementation of the \$0.19 per therm portion of UNS' PGA
7 surcharge request related to higher commodity costs, for a 12-month period beginning November
8 1, 2005.

9 17. Regarding the El Paso rate increase costs, Staff believes that any PGA surcharge
10 related to those costs should be implemented beginning in January 2006, consistent with the time
11 UNS will actually begin incurring those costs. Further, given that there is some possibility that the
12 final rates El Paso implements could be some amount lower than the proposed El Paso rates which
13 go into effect January 1, 2006, Staff believes that implementation of a \$0.06 per therm portion of
14 the PGA surcharge to reflect higher El Paso costs is reasonable. This represents over three
15 quarters of the \$0.08 per therm El Paso-related portion of the proposed \$0.27 per therm PGA
16 surcharge.

17 18. In summary, the combination of the commodity and El Paso portions of the PGA
18 surcharge as contemplated by Staff would result in the implementation of a \$0.19 per therm PGA
19 surcharge in November 2005, with the PGA surcharge increasing to \$0.25 per therm in January
20 2006 and continuing through October 2006.

21 19. After this PGA surcharge expires at the end of October 2006, Staff believes there is
22 some benefit in then implementing a \$0.05 per therm PGA surcharge which would be in effect
23 until the PGA bank balance reaches zero or the Commission orders otherwise. This would provide
24 an additional relatively small increment of on-going relief to UNS after the larger PGA surcharge
25 expires at the end of October 2006, possibly obviating the need for another PGA surcharge filing
26 in the fall of 2006.

27 20. Staff's proposal would also result in having in effect a short phase-in period for the
28 PGA surcharge, with the November and December 2005 PGA surcharges of \$0.19 per therm

1 ramping up to the \$0.25 per therm. Such a result is logical in this case given the timing of the El
2 Paso rate case schedule.

3 21. It should be noted that, apart from the level of the PGA surcharge being approved in
4 this proceeding, the monthly PGA rate is projected to continue to rise through 2005 and 2006,
5 subject to the \$0.10 per therm band. Thus the increased cost of gas UNS customers will be seeing
6 on their bills will be the sum of the higher monthly PGA rate and the year-over-year increase in the
7 monthly PGA rate.

8 22. UNS' requested implementation date of October 1, 2005, does not provide time for
9 the Commission to fully consider and act on the filing, so an implementation date of November 1,
10 2005 (the beginning of the November billing cycle) is more appropriate.

11 23. While Staff is recommending the PGA surcharge design described above, there are
12 a variety of other possible scenarios that the Commission may wish to consider in addressing
13 UNS' application. Attached to this memo are pages listing 12 possible scenarios, including UNS'
14 proposal (Scenario One) and Staff's proposal (Scenario Four). All scenarios assume any PGA
15 surcharge is implemented starting in November 2005.

16 24. Also attached are sheets showing the PGA bank balance levels under each scenario
17 for each month, the monthly impact of the PGA surcharge in each month, and the projected
18 average residential monthly bill each month under each scenario. Staff would note that certain of
19 these scenarios, such as the "Do Nothing" scenario are provided to illustrate a range of possible
20 PGA surcharge levels, but in some cases do not appear to address the projected undercollected
21 PGA bank balance on an on-going basis to the extent which seems to be necessary.

22 25. Under UNS' proposed PGA surcharge, the monthly PGA bank balance is projected
23 to increase through the winter of 2005-2006, then decline to near zero in the summer of 2006,
24 before increasing again to approximately \$14.6 million in January 2007. By comparison, Staff's
25 proposed PGA surcharge follows a roughly similar pattern, though recoveries are shifted a small
26 amount into the future. However, by January 2007, the projected PGA bank balance under Staff's
27 proposal is \$16.2 million, within \$1.6 million of where the bank balance would be under UNS'
28 ...

proposal, and under Staff's proposal there would still be a \$0.05 per therm surcharge in place to further address any undercollection.

26. The inclusion of a CARES program exemption, as discussed below, would increase the projected bank balances under any of the possible scenarios, as discussed below for the UNS and Staff proposals.

27. One concern the Commission has expressed in regard to natural gas prices is the impact of a sizable PGA surcharge on low income customers. Previously, in Decision No. 66861 (March 23, 2004), the Commission exempted UNS customers taking service under the Customer Assistance Residential Energy Support ("CARES") tariff, which provides a rate discount to low income customers, from paying the PGA surcharge approved in that decision.

28. Staff believes that a similar provision is warranted in this case and recommends that CARES customers be exempted from paying the PGA surcharge levels approved in this proceeding. UNS estimates that under its proposed PGA surcharge level, exempting CARES customers will result in a reduced PGA bank balance collection of \$762,335 over the proposed 12-month period. Under Staff's proposal, the CARES exemption would reduce the PGA bank balance collection by approximately \$651,000 over the proposed 12-month period.

29. The table below shows what an average residential customer in January, using 105 therms, paid in January 2005 and is projected to pay in January 2006 under the UNS proposal, Staff proposal, and Do Nothing scenario.

Bill Component	January 2005 – Actual Bill	January 2006 – UNS Proposal	January 2006 – Staff Proposal	January 2006 – Do Nothing Scenario
Customer Charge	\$7.00	\$7.00	\$7.00	\$7.00
Tariffed Rate - (\$0.7004 per therm)	\$73.54	\$73.54	\$73.54	\$73.54
Monthly PGA Rate	\$18.15 (\$0.1729 per therm)	\$28.27 (\$0.2692 per therm)	\$28.27 (\$0.2692 per therm)	\$28.27 (\$0.2692 per therm)

PGA Surcharge		\$28.35	\$26.25	\$3.15
	\$0.00	(\$0.27 per therm)	(\$0.25 per therm)	(\$0.03 per therm)
Total Bill	\$98.44	\$136.79	\$134.70	\$111.66
Percent Increase				
Over Jan. 2005	NA	39.0%	36.8%	13.4%
Percent Increase				
Over Jan. 2005	NA	39.0%	36.8%	13.4%

Note: Bill estimates shown in this memo and attachments do not include taxes and regulatory assessments.

30. It is worth noting that of the total increase shown under the UNS and Staff proposals, roughly one third of that increase is projected to result from the automatic movement of the monthly PGA rate and the current \$0.03 per therm PGA surcharge as shown under the Do Nothing scenario, with approximately two thirds being attributable to the increased PGA surcharge.

31. The Commission has placed a strong emphasis on Arizona local distribution companies, including UNS, conducting strong outreach efforts to try to make customers aware of what is happening regarding natural gas prices and the rates they pay as well as possible methods for customers to address the rising cost of natural gas service in Arizona.

32. At the Commission's September 8, 2005 Natural Gas Forum, there was a significant amount of discussion regarding such outreach efforts in light of the impending winter heating season.

33. Staff has recommended approval of a PGA surcharge of \$0.19 per therm effective in November and December 2005, a PGA surcharge of \$0.25 per therm effective January 2006 through October 2006, and a PGA surcharge of \$0.05 per therm effective from November 2006 until UNS' PGA bank balance reaches zero or the Commission orders otherwise, whichever comes first.

34. Staff has further recommended that customers enrolled in the CARES program be exempted from paying the PGA surcharge approved in this proceeding.

...

CONCLUSIONS OF LAW

ORDER

• • •

1 IT IS FURTHER ORDERED that UNS engage in an immediate, highly visible and
2 meaningful public relations campaign, in consultation with Staff, to inform its customers of (1) the
3 specific details of the PGA surcharge level(s) approved in this proceeding and how it benefits
4 customers now rather than later to recover natural gas costs; (2) the impact of the PGA surcharge
5 level(s) on customer bills; (3) general natural gas price circumstances leading to the PGA
6 surcharge; and (4) ways in which UNS' customers can try to manage the higher rates they are
7 facing. Heavy emphasis should be placed on promoting programs such as budget billing
8 (especially during the time of year that it would be most beneficial to customers to apply), the
9 CARES program, and ways to reduce consumption.

10 IT IS FURTHER ORDERED that this Order shall become effective immediately.

11
12 **BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

13
14 CHAIRMAN

COMMISSIONER

COMMISSIONER

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17 COMMISSIONER

COMMISSIONER

18 IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive
19 Director of the Arizona Corporation Commission, have
20 hereunto, set my hand and caused the official seal of this
21 Commission to be affixed at the Capitol, in the City of
22 Phoenix, this _____ day of _____, 2005.

23 _____
24 BRIAN C. McNEIL
Executive Director

25 DISSENT: _____

26
27 DISSENT: _____

28 EGJ:BGG:lhmk/L

SERVICE LIST FOR: UNS Gas, Inc.
DOCKET NO. G-04204A-05-0596

Mr. David Couture
Unisource Energy Services
4350 East Irvington Road
Mailstop OH123
Tucson, Arizona 85702

Mr. Ernest G. Johnson
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Mr. Christopher C. Kempley
Chief Counsel
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007